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No. 03-1415

In the Supreme Court of the United States

DAVID A. RAYMOND AND LORI RAYMOND, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether, under Section 61(a) of the Internal Revenue Code, 26 U.S.C. 61(a), petitioners' gross income from the proceeds of litigation includes the portion of their damages recovery that was paid to their attorneys pursuant to a contingent fee agreement.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-21) is reported at 355 F.3d 107. The opinion of the District Court (Pet. App. 22-36) is reported at 247 F. Supp. 2d 548.

JURISDICTION

The judgment of the court of appeals was entered on January 13, 2004. The petition for a writ of certiorari was filed on April 9, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner David A. Raymond brought suit against IBM Corporation, his employer, for wrongful termination of his employment. He was awarded damages in the amount of $869,156. Pet. App. 23. Under the contingent fee agreement that petitioner had made with his attorneys, the attorneys were authorized to, and did, retain $306,898.01 of the damages award. *Id.* at 24.

Petitioner filed a joint tax return for 1998 with his wife, petitioner Lori Raymond, on which the entire amount of the judgment, including the portion retained by Mr. Raymond's attorneys, was included in gross income. Pet. App. 24. Although petitioners' attorneys fees were deductible for regular income tax purposes, they were not allowable as a deduction for purposes of the alternative minimum tax (AMT). See 26 U.S.C. 56(b)(1)(A)(i). As a consequence, petitioners incurred an alternative minimum tax liability. In December 1999, petitioners filed an amended 1998 return. On the amended return, petitioners excluded from their gross income the amount paid to their attorneys under the contingent fee agreement. This exclusion eliminated petitioners' AMT liability and, on that basis, petitioners claimed that the IRS owed them a refund of approximately $55,000. The IRS denied the claim. Pet. App. 3.

2. Petitioners filed suit in the United States District Court for the District of Vermont, challenging the denial of their refund claim. Petitioners moved for summary judgment, contending that, as a matter of law, the amount paid as a contingent fee to their attorneys was not includable in their gross income. The government cross-moved for summary judgment, arguing that the entire amount of the judgment was includable as gross

income. The district court granted petitioners' motion for summary judgment, holding that petitioners' gross income did not include the portion of their damages award that was paid to their attorneys under the contingent fee agreement. Pet. App. 36.

3. The court of appeals reversed and remanded. Pet. App. 1-21. The court held that petitioners' attorneys did not acquire an ownership interest in the cause of action under the contingent fee agreement, but acquired only a lien—a security interest—in a fund owned by petitioners. *Id.* at 14-15. The court of appeals further held that federal tax law principles explained in *Helvering* v. *Horst*, 311 U.S. 112 (1940), and other decisions of this Court required that the entire amount of the damages award, including the portion paid to petitioners' attorneys, be included in petitioners' gross income. Pet. App. 16-21.

The court explained that "whether something is 'gross income' begins with whether it can reasonably be considered a 'gain' to the taxpayer under 26 U.S.C. § 61(a)." Pet. App. 16. The court rejected petitioners' contention that they received no gain from the attorney's fees portion of the award because they never received those funds and had no right to them in light of the lien placed on them under Vermont law. The court held that this Court's decision in *Horst* makes clear that "a taxpayer can realize a gain subject to taxation where, although he 'never receives the money, he derives money's worth from the disposition of [the source of the income] which he has used as money or money's worth in the procuring of a satisfaction which is procurable only by the expenditure of money or money's worth.'" *Ibid.* (quoting *Horst*, 311 U.S. at 117). The court concluded that Mr. Raymond "control[led] the source of the income [and] . . . divert[ed] the

payment from himself to others as the means of procuring the satisfaction of his wants." *Ibid.* (quoting *Horst*, 311 U.S. at 116-117). Specifically, "[h]e diverted a portion of his judgment to his attorney in the service of receiving the remainder of that judgment—certainly a result 'procurable only by the expenditure of money or money's worth.'" *Ibid.* (quoting *Horst*, 311 U.S. at 117). Accordingly, the court held, "the judgment flowing to [petitioner] is income to him, and the expense of producing that income—his attorney's fee—is a deductible expense." *Ibid.* While the fact that the AMT precludes petitioners from taking advantage of that deduction may be "unfortunate," the court said, "it is not a reason to create an artificial contingent-fee exception to the rule that one is taxable on income from a source over which one retains control." *Id.* at 16-17.

DISCUSSION

This case presents the same question presented in *Commissioner* v. *Banks*, No. 03-892, and *Commissioner* v. *Banaitis*, No. 03-907. The Commissioner's petitions for certiorari in those cases were granted on March 29, 2004, and the cases were consolidated. See 123 S. Ct. 1712 and 1713 (2004). The Court's decision in *Banks* and *Banaitis* in all likelihood will be dispositive here. Accordingly, the petition in this case should be held for appropriate disposition in light of the Court's disposition of *Banks* and *Banaitis*.

CONCLUSION

The petition should be held and then disposed of as appropriate in light of the disposition of *Commissioner* v. *Banks*, No. 03-892, and *Commissioner* v. *Banaitis*, No. 03-907.

Respectfully submitted.

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